RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 16, 1998 **LETTER 1267**

IN A NUTSHELL: The world is **drastically over-producing.** Furthermore, the world (meaning mostly the US) can't absorb all the oil, corn, textiles, cars, steel, toys, cameras (and on and on) being produced. So what's happening? Prices are sagging, farm products have tanked, commodity indices are at quarter-century lows, oil is under twelve bucks a barrel -- everything, all merchandise (with only one week until Christmas) is **"on sale."**

In the face of worldwide price deflation, central banks are fighting the bear -- cutting rates in unison while pumping up their respective money supplies. Encouraged by surging liquidity, investors continue to buy stocks -- buy, buy, buy, despite record high valuations, despite a steadily declining trend of corporate earnings.

And why not buy? Everyone is espousing **"the long term."** The argument runs like this: "So what if the market sells off? Listen, I'm buying for the long term. If the market declines the Fed will step in and turn it around. Haven't they done it time and time again? Hey, the Dow hasn't broken below the low of a preceding year in over sixteen years or ever since 1982. Bear markets, real bear markets -- they're history. I'm confident because we've got Alan Greenspan at the helm. No way would Mr. G allow a real bear market to occur."

Russell View: The most fundamental fact is not that Alan Greenspan is watching over us. The most fundamental fact today is **world over-production.** How do you get around over-production? Surging liquidity won't do it, sale prices, discount prices, won't do it. Americans are even digging into savings in their wild buying spree, and that isn't solving the problem. The only way to solve over-production is to cut back, lay off, liquidate or bankrupt part of the sources of production (it's now happening in Asia). That process is called a bear market.

"The more the equity bubble inflates, the more that consumers will feel comfortable in spending at a pace that is in excess of their income growth. Thus, the savings rate could become even more depressed and the current account deficit will widen further. These trends will be unsustainable, and the inevitable retrenchment could be painful." [From the December *Bank Credit Analyst* -- (514)499-9706].

The Fed obviously knows that the stock market is in a "bubble mode." But Greenspan must believe that a stock market bubble is preferable to a recession. Furthermore, if the stock market starts to cave in, Greenspan feels that by lowering rates he can brake the fall, thereby manufacturing a "soft landing" in both the stock market and the economy.

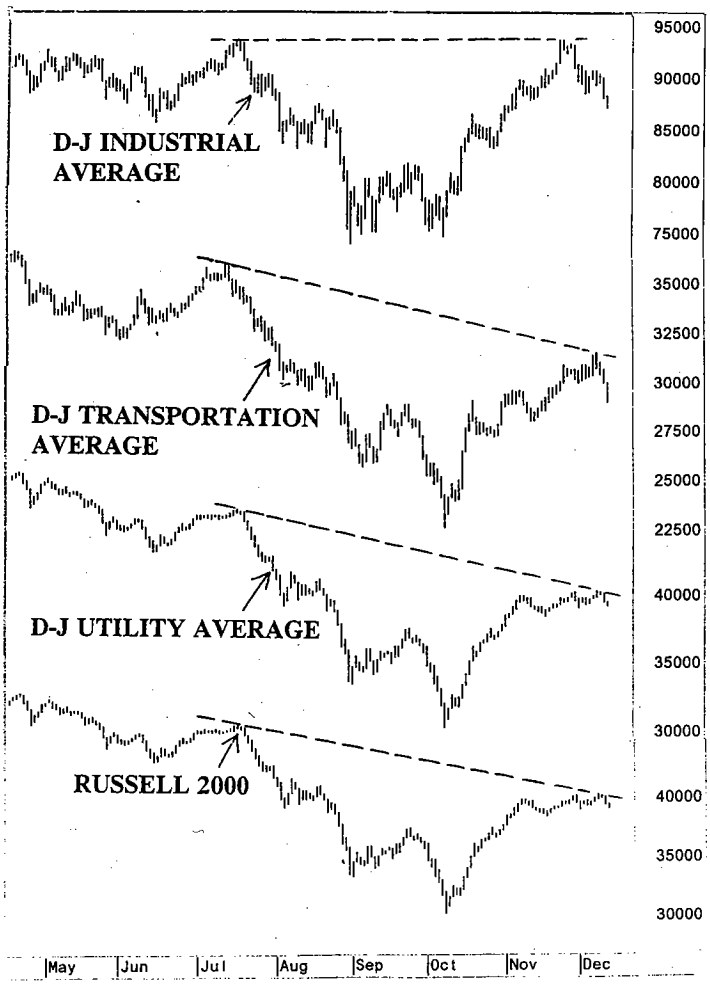
However, Greenspan knows that there are two phenomena that he absolutely can not tolerate -- a real bear market in stocks and an economic recession -- either of which would be deadly because (1) the consumer is so loaded with stocks and so dependent on stocks as "savings," and (2) because a recession would devastate the economy and cause consumers to pull back on their buying, thus setting off a situation in which the stock market and the economy would bearishly feed on each other.

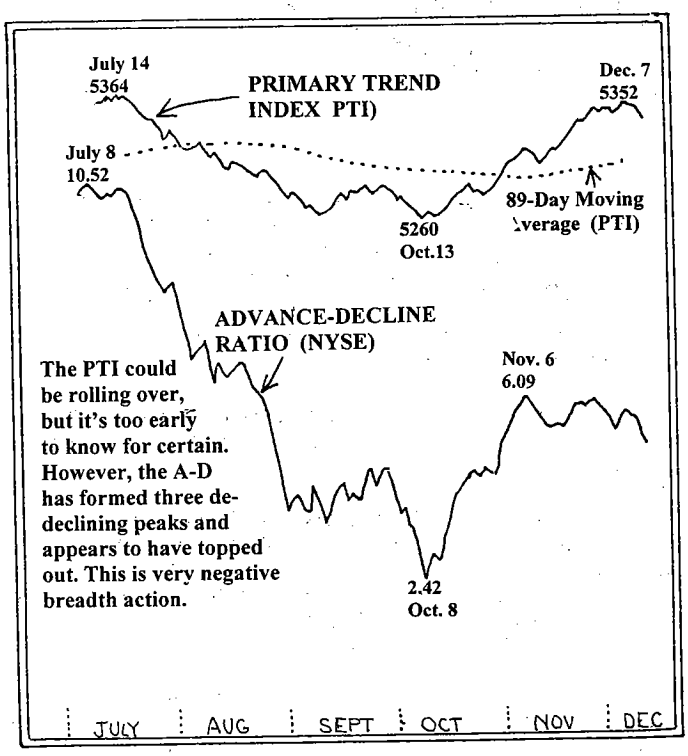
Dec. 4 DJIA 9016.14; PTI 5348; A-D Ratio +5.63
Dec. 11 DJIA 8821.76; PTI 5338; A-D Ratio +5.03
Dow Yield: 1.72%; Dow Price/Earnings: 23.8
Dow 144-day MA: 8631; Dow 34-day MA: 8930
Dow Times Book Value: 5.53; PTI 89-day MA: 5310
Percentage of Undervalued Blue-chips: 4%
Gold 34-day MA: 296

PRICE ACTION: In recent Letters I have drawn attention to two problems associated with the explosive October-November rally (see page 1 charts).

(1) On the advance, the **Transports** have lagged far behind the Dow. Thus, a major non-confirmation now exists with Transports persistently refusing to confirm the new high in the Dow. The non-confirmation by the Transports is even more striking in the face of the collapse in oil prices (cheap oil is always a major plus for the carriers).

(2) The broad market, as measured by the **advance-decline ratio,** recouped (see page 2 chart) only one-third of its April to October losses. This means that the recovery was concentrated in a limited number of big-cap stocks, and, of course, the rally was further fired up by wild speculation in almost any stock with a .com in its name.





(3) Interestingly, the **D-J Utility Average** has halted well short of its bull market high of 320.51, this despite the collapse in oil and the strength in bonds (both of which, historically, have been major pluses for the utilities). While playing no part in Dow Theory, the bellwether Utility Average often leads the rest of the market both on the upside and the downside.

(4) The **Russell 2000** (the lesser priced 2000 of a 3000 universe of stocks) looks very much like the A-D ratio. It also looks much like the average investor's portfolio. The Russell 2000 has now recovered a little better than half of its earlier losses.

I want to stress that when mapping out a scenario of the forthcoming situation, I always place **the stock market first.** In other words, I defer to the stock market. First, I try to make sense out of what the stock market is doing -- and secondly, I attempt to understand what's behind the movements of the market.

For example, I accepted the August 4 market action as an authentic signal for a primary bear market under Dow Theory. From there I attempted to fathom what the bear market signal might be telling us about the upcoming business cycle and the markets. This, of course, differs from those who study economic statistics -- and from their studies of the economy they attempt to predict what the stock market will do.

PUZZLES: Gold fades, oil is smashed, the commodity indices collapse, scrap steel drops precipitously, copper on its low, and consumers refuse to buy anything unless it's "on sale." As far as prices are concerned, there's just no inflation. In the face of the no-inflation economy, **in the face of stagnant gold, the Fed feels safe in allowing the money supply to soar.**

Did I say "no inflation?" Well, let me revise that, there has been plenty of inflation -- but it's been **confined to the stock market.**

What about the US economy? It's been held up by massive consumer spending. The big question: Will consumers keep up their massive spending? And what happens to the economy if or when consumer spending turns down? Ah, this is why the trend of the stock market is **so absolutely critical now.** Because if stocks turn down, if the bear sinks his teeth into Wall Street again, then the public (which is loaded with stocks) is going to become frightened. And if they become frightened, they're going to cut back on the buying and they're going to begin to **save.** If that happens, the bear will be smiling.

Sentiment: In all the years that I've dealt with the market I've never seen such ingrained, all-encompassing bullishness. I remember the intense, really wild bullishness towards the end of 1968, but that bullishness was on a much smaller scale (far fewer participants) than what I see today. (Item: through the first nine months of this year, investors poured a record net $370 billion into mutual funds -- or well over $1 billion a day!)

Today's bullishness has enveloped almost every area of American life. You read about the stock market in the women's magazines, in expanded sections of the daily newspaper, in the flood of direct mail pieces, on TV, on the radio, in the gossip columns, in *Time*, *Newsweek*, *USA Today*, *Fortune*, *Forbes*, the *New Yorker* -- it's everywhere, it has swept the nation. (Item: the largest daily newspaper circulation -- the *Wall Street Journal.*)

I remember back in the '40s and '50s when business and the stock market were literally unknown subjects. College kids were majoring in communications, pre-med, liberal arts, anything but (ugh) business or Wall Street. Now business is, as the November 30 *WSJ* puts it, enjoying "a bull run at colleges."

MONDAY, NOVEMBER 30, 1998

Economics Enjoys a Bull Run at Colleges

Once Perplexing Subject Is a Top Major for Students

By Thomas Mabry
Staff Reporter of The Wall Street Journal.

NEW YORK—The dismal science is in vogue again on campus.

After years of trailing history, English and biology as the top undergraduate major, economics has overtaken them all. Nationwide, 7% of undergraduates declared economics their major in 1997, up from 5% in 1991, according to the College Board. Economics is now the most popular major at Princeton University, Yale University and Columbia University, and it is the second most popular major at Harvard University, Stanford University and the University of Pennsylvania.

Economics professors say the subject's popularity is cyclical, rising when the economy is booming and students are looking for ways to get rich. But this time, they say, the boom is being fueled by a new generation of students who are more interested in the subject than their predecessors were.

"Students are more aware of economics and more interested in it," says Thomas Nechyba, an assistant professor of economics at Duke University. "They're more aware of the role it plays in their lives."

Mr. Nechyba says he has noticed a change in the attitudes of students in his introductory economics class. Instead of asking how much money they can make, students are asking why the economy behaves as it does, he says.

Recalling President Clinton's 1992 campaign slogan, Mr. Nechyba says, "It's not the economy, stupid, it's us."

Economics professors say the subject's popularity is also being fueled by the fact that it is a prerequisite for many graduate programs in business and law. Economics is the most common major for law school applicants in 1992 and 1995 by Michael Nieswiadomy, a professor of economics at the University of North Texas. (Criminology majors, with an average score of 146, finished dead last.) When the study was ex-

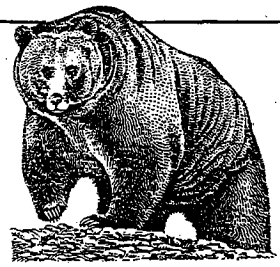
I'm not a spoil-sport. After all, I've made my living writing about the stock market ever since 1958. But there's something almost unhealthy about the current obsession with stocks, the market, making money. Money is important, business is important, nobody's disputing that. But I've just never seen such mass craziness, such greed -- I don't know what else to call it.

They say that toward the end of every century a great revival in religion seems to occur. Now, as we close in on the end of this century, instead of religion it seems that there has been a great revival of **interest in wealth.** After all, who are the heroes of today? Who or what are the names everybody recognizes? Warren Buffett, Bill Gates, George Soros, Peter Lynch, the rich sports figures, the rich Hollywood stars. Today the newspapers tell us how much each new film makes. The size of the contracts of leading sports figures are published. Top prices for art are listed. Magazines promote the "Fortune 500," the "500 Richest Americans," the "50 Best Cities for Business." We're informed, around the clock, about quarterly corporate profits vs. "the expectations." Talking heads parade endlessly across our TV screen, each purporting to tell us which way the market is heading and what stock to buy.

The mind boggles (at least mine does) at this un-ending wave of money-oriented news. Clearly "making money" is the new religion. Personally, I don't think it's healthy. No, I'll be honest, I think it's a bit kooky. I think it's a mania. And judging by past history, manias don't end well.

Conclusion: This is the age of the computer and the Internet, no question about it. Things change, science changes, medicine changes, business changes -- but one thing doesn't change. That one thing is human psychology. So saying, this might be a good time to repeat the wise words of the founder and first editor of the *Wall Street Journal*, Charles H. Dow. The following is from a *WSJ* editorial written by Dow in 1903.

"There is always a disposition in people's minds to think that existing conditions will be permanent. When the market is down and dull, it is hard to make people believe that this is the prelude to a period of activity and advance. When prices are up and the country is prosperous, it is always said that while preceding booms have not lasted, there are circumstances connected with this one which make it unlike its predecessors and give assurance of permanency. The one fact pertaining to all conditions is that they will change."



INVESTMENT POSITION: A primary bear market under Dow Theory was signaled on August 4. Four months have now elapsed since then, and the Dow Theory bear signal has not been rescinded. Which is why the big bad bear remains in the box.

To participate in the stock market bubble or to desist, that is the question? If you ignore all other considerations and simply follow my PTI you probably bought some stocks and have enjoyed the ride. However, if you are a Dow Theorist, you've had a lot of reasons to remain on the sidelines, and I've talked about those reasons at length.

If you're in the market based on the rising PTI, you're a momentum player, which means that you are depending on the market's upward momentum (regardless of extreme overvaluation) to make money. There's nothing wrong with that, as long as you are aware of the **risks.** It's much like betting on a hot football team like the Packers. The only trouble is that while last year the Packers were mostly unbeatable, this year they are barely above 50% and struggling through every game.

Many of the bears are advising that you avoid stocks and load up on Treasury bonds -- based on their belief that the nation will be heading for slow growth, no growth or recession next year. On this basis, the bears believe that the Fed will continue to drive rates down, with the yield on the long bond sinking to 4.25% or perhaps even below 4%.

My only reservation with this thinking is that it is almost too "pat." What could be wrong with the "load up on T-bonds" position? Well, the economy could fool everybody and actually pick up in '99, but I don't think that's a strong possibility. The thing that keeps me from loading up 100% on bonds is **the dollar.** If (surprise) the dollar turns extremely weak you're going to see foreign selling of T-bonds, in which case US bond holders will wish they were in euros or D-marks or US T-bills.

Remember, the US money supply has been roaring all year, meaning that the US and the world is being flooded with dollars. Enter the euro in 1999. With European and probably most Asian central banks heading to diversify out of dollars and into euros, there could be some surprises ahead. Personally, right now I'm opting for about half in T-bonds and half in T-bills. And if the bonds turn weak, I'll be 100% in T-bills. What, me worry? Nah.

NOTES & QUOTES: Last week nine European nations cut interest rates simultaneously. It's obvious (at least to me) that the various central banks believe that interest rate cuts and enough liquidity will beat the bear. So what I've predicted all along is happening, **the battle of governments and the central banks vs. the bear is on.** Meanwhile, signs of the bear are emerging. I pasted up this montage from news clips, all of which appeared on a single day in December. As the bear market continues, we'll see a lot more of these items. Remember, the Dow Theory bear signal has already been given -- but how the picture unfolds, how the markets develop, all that will be dragged out and extended (because of government manipulations), and it will be confusing. But in the end the bear will win. The bear is the tidal force, the government manipulations are the ripples.

Sears Says Sales and Profit Won't Meet Forecasts

■ **Retail:** Stock falls 3.5% on the news. Chain blames sales drop on lower demand for winter apparel and loss of customers to rivals.

From Times Wire Services

Sears, Roebuck & Co. said Wednesday [illegible] in November and

U.S. AND I.M.F. MADE ASIA CRISIS WORSE, WORLD BANK FINDS

INTEREST RATES FAULTED

Blow-by-Blow Report on Errors Omits Any Direct Mention, in a Conciliatory Move

By DAVID E. SANGER

WASHINGTON, Dec. 2 — The deci- [illegible]

Risk of Global Recession Is 'Substantial,' World Bank Says in an Annual Report

By MICHAEL M. PHILLIPS
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON—The sense of economic doom may be receding in the U.S., but the World Bank warned that global recession could [illegible]

suming its usual pace of 3.5% after the turn of the millennium, the bank predicted.

More than overall economic growth rates, per-capita rates reveal the depth of the hardship caused by the global financial crisis because they suggest how much [illegible] ore the average individual produces, and erefore takes home, each year.

Mr. Stiglitz said a major source of the

Seattle Area Likely to Be Hit Hard by New Boeing Layoffs

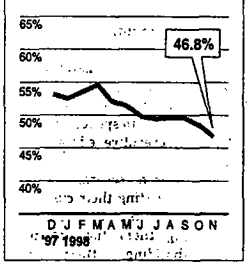
■ **Economy:** Washington state already is reeling from the Asian crisis. Fortunately, the Puget Sound region has diversified from its company town days.

By LESLIE HELM
TIMES STAFF WRITER

SEATTLE—The new wave of job cuts announced by **Boeing** Co. on Tuesday throws a wet blanket over the holiday cheer here and is likely to cool the city's hot economy.

Purchasing managers' index

Tracks overall business activity of more than 300 industrial companies.



Source: Natl. Assn. of Purchasing Mgt. AP

* *

This from *Market Logic* [(800)442-9000]: **"Debt (margin)** -- Sell signal! Margin debt dropped $7.4 billion in October to $130.2 billion, is now $6 billion below the 12-month average and has declined three consecutive months from the record peak of $154 billion in July. Margin typically contracts in a bear market." **Russell Comment:** Back in the '60s my old friend, Dr. Sloan Wilson, wrote a book on NYSE margins as it collates with the primary trend of the market. Sloan showed where margins are "the speculators' best friend." Margins rise in a bull market, but in a bear market the speculators are consistently beaten. As the speculators lick their wounds and leave Wall Street, margin accounts decline.

* *

I see *(WSJ,* Dec. 2) that my old friend, Marty Zweig, is moving to get out of the fund business. Good move Marty, I think the timing is right. Do it, do it, do it. In my mind I can see the time when funds of all kinds will be as despised as they are now loved. But it will take time, maybe three to five years. No movement this huge dies easily.

Marty's leaving reminds me -- there are only four of us old timers left; we're the market writers who started in the early '60s (actually, I started in '58). The four are Jimmy Dines, Joey Granville, Sir Harry Schultz and me. We're still at it. You have to love this business to stay with it, but I really think all four of us do love the business.

* *

Just how serious is the Y2K problem? I hear all varieties of opinions from confidence to predictions of disaster. The fact is that Y2K remains a mystery. My guess is that much of "big" US industry is going to be OK, but a lot of small businesses will not be OK. A government "report card" was issued in mid-November by a government sub-committee. Social Security is OK, Justice, Energy and State are not, Defense gets a D minus. My thinking is that the trouble will come from overseas computers and small US companies. I also think the trouble will come from glitches -- in other words, from systems that were termed "compliant," but have hidden "bugs" in them. To render systems compliant means long tedious hours in which every line of information must be corrected. The December 14 *Business Week* headlined an article, "Y2K Is Worse Than Anyone Thought. The final reckoning for the bug could hit $1 trillion." **Conclusion:** There's going to be Y2K trouble, but nobody, NOBODY, knows **how much** trouble is in the wind. **Note:** Shortly before midnight on December 31, 1999, Jane Garvey, head of the US Federal Aviation Administraiton, will board an aircraft to fly coast-to-coast. This gesture is designed to show the US public that, despite Y2K, it is safe to fly. Here's hoping she makes it.

* *

The following from the Nov. 24 *Financial Times* (London). "Mr. Clinton often notes in private that the great presidents have tended to achieve greatness in the teeth of crisis, pointing to Abraham Lincoln and Franklin Roosevelt. It is harder, he says, to earn such a reputation in times of peace and prosperity. If the international economic turmoil does truly require a radical response, perhaps Mr. Clinton might have one last shot at greatness." **Russell Comment:** Alone in his room, I imagine that Clinton might envision his "legacy" as that of a lying, perjuring, adulterous president who faced impeachment or censure. But wait, maybe if he did something really historic he might have a better place in history. Here's an idea -- what about a new world economic order? That might work. Hey, isn't the world in a mess now? This could be the ticket -- a new economic order. Why not try that one? **Russell Opinion:** Forget it Clinton, it's not going to work. It won't work (1) because nations will give up just so much of their sovereignty. And (2) there are cycles of greed and fear and nobody has yet learned how to outlaw them. (3) You can see how much resistance there already is to the IMF and its strictures and rules.

Clinton ponders new world economic order

By Gerard Baker, travelling with President Clinton

When Bill Clinton, US president, was asked during his Tokyo visit

Waving his arms for emphasis, he recalled how investment flooded into the Korean economy in the 1980s and most of the 1990s. Then, "problems come up.

change to the whole system is needed. Now that he has only 18 months left in his administration and the threat of impeachment is fading, it is an issue to which he

US Federal Reserve. Their view is that the bulk of the blame for the crisis of the past year lies with the countries themselves.

calls for radical changes to in national financial markets. A say he was impressed by som the arguments.

Mr Clinton often notes in

* *

For years rumor had it that the Fed through its Stabilization Fund would manipulate the stock market whenever the market needed "propping up." Not so, according to Fed Chairman Greenspan. Said Mr. G, and I quote, *"The Federal Reserve has never intervened in the US equity market in any form, either in the equity market itself or in the futures market, for its own account."* He also denied that the Fed had any kind of arrangement with dealers to manipulate the market. **Russell Comment**: Of course, some people believe that dropping the discount rate twice and the Fed Funds three times within the space of a few months might just be considered a bit of manipulation.

* *

Lawrence Tisch, CEO of Loews Corp., was bearish at the wrong time. During 1997 he moved Loews to a heavily short position; the company lost $918 million. Then the losses mounted; $524 million in the first quarter of '98, and $134 million in the second quarter. Then he picked up profits of $368 million in the third quarter. But being right too soon cost his company $1.2 billion. What are the lessons to be learned here? I think they're what I've always maintained. Short selling is extremely difficult because you're completely dependent on timing. Time your shorts wrong, and the market will take your head off. Remember, even in a bear market you will get those big rallies, and if you're short during an explosive bear market rally -- well, you do the math.

* *

And you thought US taxes were outrageous? Well, it's worse in Canada, as this headline from the *Financial Times* suggests. Furthermore, with the **Canadian dollar** near its all-time low, as one Canadian put it, "If you work in the US you get a 55% salary increase just for showing up." Actually, Canadian taxes as a percentage of GDP are about 36%, well below the European average of 42% but well above the US average of roughly 27%. Canadian taxpayers pay 54% on every extra dollar they earn above US $38,000 (the US is about 35%). The richest fifth of Canadians have seen their tax bills jump more than 30% in real dollars over the last 10 years. No wonder so many Canadians are heading for the US (creating a brain-drain in Canada).

Low US tax rates draw Canadians southwards

Edward Alden finds the impact of a weak currency and tax differences are drawing away talent in high-technology areas

round to what has become a familiar but still wrenching debate for Canadians: to what extent can Canada, a

labour, is driving away investment and talented workers. Jon Kesselman, an economist at the University

Michael ' Mendelt scholar at the Caled tute of Social Poli higher Canadian

* *

The following is from the Lex column (Nov. 30) of London's *Financial Times:* "With the US stock market back near its all-time high, most investors secretly suspect shares are overvalued. But they also believe equities will produce the best returns over the long term. If both beliefs are true, could it be rational to keep buying? A look at the numbers isn't encouraging. Lex argued last month that fair value for the S&P 500 is 800-850 and that, from such a level, investors could expect real returns of about 6% annually over the long term. But with the index at about 1185 today, such returns will be unachievable. In fact, if this stab at fair value is correct, real returns will average 2% on a 10-year horizon -- and still only 4% over a 20-year span. With such meager returns in prospect, the argument that equities will outperform in the long run looks pretty suspect. So why do investors still hang on in there? Collective psychology is the answer. Because most investors believe in the superior performance of equities, they hold on through crashes and buy the dips."

* *

The Hong Kong government spent billions of dollars as it intervened in the Hong Kong stock market in a massive effort to manipulate stocks higher. It didn't work, or at least it didn't work for long. On top of that, Hong Kong is now in its worst recession on record with GDP dropping at a crushing 7% rate this year.

Hong Kong in worst recession

Hong Kong is in its worst recession since records began. Figures released yesterday show a 7 per cent contraction in gross domestic product for the third quarter, compared with the equivalent period of 1997. The government forecasts a full-year drop in GDP of 5 per cent. With economic contraction set to continue, businesses fear the government will cut spending or raise taxes. **Page 24**

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Want to be a corporate lawyer? Last week my wife, Faye (who is a partner in Brobeck, Phleger, and Harrison, a large law firm), told me that she had to close a deal, and that she was off to Japan. I asked, "When are you leaving?" She said, "Wednesday." I asked, "When are you coming back?" Faye replied, "Friday." I gasped, "What! You're going to Japan Wednesday and coming back two days later on Friday? Am I hearing right?" "You're hearing right," said Faye. Yep, it's a new world, and, gulp, and I'm afraid I feel like I'm standing still.

* *

The following is from *Howard Investment Counsel Inc.* out of Vancouver: "The two great capital markets are reciprocals of each other. Together they are so huge that the global equity investing challenge is primarily a question of which of the two big markets to choose for overweight -- or even for exposure at all. The successful global strategy of the 1990s has been zero exposure to Japan with an overweight in New York. Any managers who hung on to serious exposure to Japan have had to

take up other careers. Money flows within these markets. When Japan is strong, as it was in the late 1980s, New York is starving for liquidity. Conversely, where Tokyo is weak, money flows into the US market, not just from Japanese sources, but from global investors reallocating their national exposures. We learned in 1987 that there isn't enough money in the world to drive both these mega-markets up sharply simultaneously. Ideally, we need one to decline or move only modestly, to free up funds to drive up the other." **Russell Comment:** A very interesting and original interpretation, and it does seems to have validity, at least, judging by the action of the two markets.

* *

When I was a young guy (pre-war) living in NYC I used to go to the St. Nicholas Arena on 65th Street off Columbus Avenue to see the pro wrestlers. In those days it was Jim Londos, Man Mountain Dean and Strangler Lewis who were the stars. Then along came Antinino Rocka from Argentina, who astounded us with his athletic jumps and holds. Antinino literally changed wrestling. Then came a long multi-decade hiatus; pro wrestling died. But no longer. With the rise of the current crazies, wrestling has become the hottest thing on cable TV. Hulk Hogan, Macho Man Randy Savage, Stone Cold Steve Austin, the Undertaker, they've captured the imagination of today's youth. On Monday night (two shows), four times as many youngsters watch pro wrestling as watch Monday Night Football (which, by the way, has been losing audience). And most recently, a new hero has emerged. He's six-foot-four, 285 pound all-world champion, Goldberg. Goldberg (his real name) is a sight -- growling, threatening, raising his fists, he challenges the world. He's fearsome, he's terrifying, he's huge -- he's Goldberg, it's madness, it's crazy, it's a great show, and the crowd goes wild.

* *

As long as I'm talking about "the old days," how about swing dancing coming back? The kids are all learning the Lindy Hop, which we used to do back in the late-'30s and '40s. What's next, the return of the big bands? Actually, it's all kind of eerie. Reminds me too much of the Depression days.

* *

With the success of that great film, "Saving Private Ryan," my generation is finally getting some attention. And what's this, a new book entitled, "The Greatest Generation," by Tom Brokaw? *American Heritage* magazine writes, "NBC's anchor man, Tom Brokaw, pays tribute to the men and women who came of age during the Great Depression, fought and won the Second World War, and returned home to build the most prosperous, best-educated society in the history of the planet." I guess I feel a little bit of pride in thinking that I'm one of the poor devils who survived the Depression and World War II and was part of the "great generation." I can tell you this -- we sure didn't feel anything like "great" at the time.

* *

More on the Net: John Liscio [*Liscio Report* -- (973)509-2256] states, "The Internet is nothing less than one of the greatest advances of disintermediation on record . . . You can now go to any manufacturer or content company instantly. **No longer do you need a middleman;** many online sites are now commerce-enabled and you can buy what you want, from whomever you want, without ever leaving your chair. Jeff Bezos of Amazon.com thinks the net store of the future should be able to guess what you want to buy before you know it yourself. The impact of technology of this sort is already transforming the global economy into a more productive, but inherently deflationary entity."

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The **net stocks** continue to surge and confound the analysts. Here's a segment from a piece by Chris Byron from the *NY Observer*. He's talking about Inktomi, which on Nov. 20 sold for 133. "Folks, here's a $3.2 billion market cap for a money-losing, $20 million (in revenue) company with doubtful prospects. How will this outfit ever make the kind of money necessary to justify that price? Answer: Unless it gets into drug smuggling, well, forget it. This year Inktomi has lost $1.15 per share, and losses in 1999 are predicted to improve to only .94 cents per share. In a best case scenario the company will report 11 cents per share in 2000 -- meaning it is now selling for (get ready!) a two-year-out price/earnings multiple of 1,216 times projected earnings (Microsoft now sells for 49 times year-ahead earnings) . . . Want another? Let's take at look at an outfit called Creative Computers, Inc. This isn't actually an Internet company at all, it's just a computer retailing operation that sells whatever and however it can (catalogues, on-line, stores, you name it). The company went public at 17 per share back in 1995, sank eventually to 3 and bounced around there until about a month ago, when it woke from the dead and started to glow like Godzilla. On Nov. 18 the stock nearly doubled in a single trading session, and as of Nov. 29 was selling at 24.75. Why? Following upon the berserk success of Internet auction site E-Bay, which went public in a Goldman IPO in September at 18 and is now selling for 147, Creative Computers announced plans for a me-too IPO for its own Internet auction site: U-Bid Inc. **Russell Comment:** Most people work hard for their money, but when it comes to Las Vegas or Wall Street, many tend to lose their minds -- and their hard-earned money.

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When I was a boy, aged six in 1930, the human population of the world was two billion. In my lifetime the world's population has almost tripled -- to just below six billion today. Can this continue? No one is sure: Last week at the Anthropological Society of America's meeting in Philadelphia the question was debated. One scientist noted that aerial and satellite views of urban centers taken over a period of years bore a striking similarity to images of cancerous tissues (particularly melanomas) invading healthy surrounding tissues. Evidently, nobody at the conference of 5,000 scientists laughed. Interestingly, while most of Europe's fertility rate is decreasing, the fertility rate in the US is increasing, mostly due to Hispanic immigration. During the past decade, 20 of 28 African nations showed increased fertility rates. Only AIDS, wars and famine, it seems, is putting a brake on the African population.

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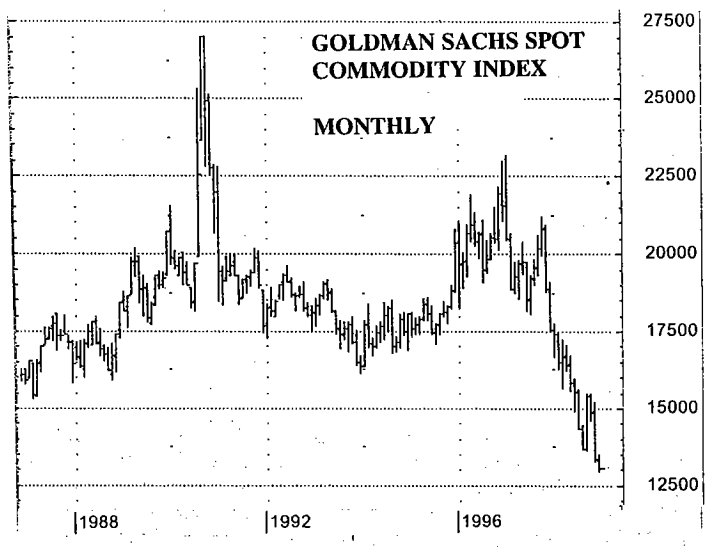
The crash in world commodities is simply amazing. Last week the Bridge-CRB index of commodities sank to a 26-year low. At the same time the Goldman Sachs Spot Commodity Index broke to a multi-decade low. Here's a monthly chart of the Goldman Index going back to 1987. With the collapse in agriculturals and oil it is going to cause a good deal of hardship among farmers and among oil producers. Expect multi-farm bankruptcies plus give-ups and mergers in the oil industry. Historically, the stock market has tended to move in direction with major commodity moves. Remember, commodities are the base of the economy, the raw materials.



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The FBI finally released its files on Frank Sinatra. Turns out Sinatra got out of the draft and World War II by pleading a perforated ear drum and psychological problems. Give me a

break. I had had a mastoid operation and also had a punctured ear drum, but I enlisted and they took me. Sinatra may have been a tough guy, but when it came to the real fight he wasn't there. But then tough guy John Wayne never saw service either. Why does all this annoy me? Then there's draft-dodger Clinton.

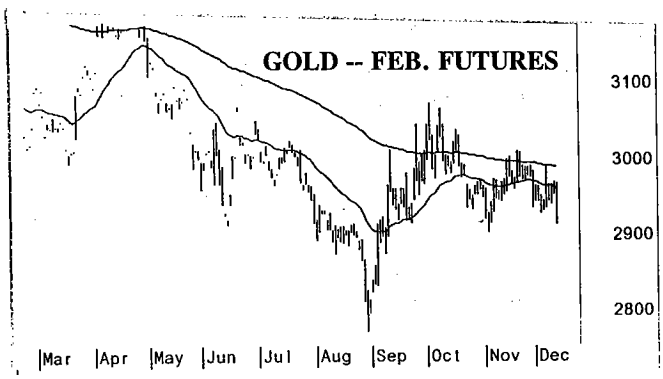
GOLD: Question -- which is proving to be the stronger force, potential inflation brought on by a surging money supply, or deflation, set off by world over-supply?

It appears that gold is providing the answer, and the answer is deflation. For despite the surging US money supply, gold, the ultimate "inflation barometer," appears totally disinterested. If anything, gold by its wobbly performance is telling us that the forces of deflation are huge and under-estimated.

As this is written, the February gold contract (futures) stands at 293. The 34-day moving average stands at 296.7 while the 144-day MA stands at 299.3. Thus the gold price and the two moving averages are all within a few points of each other -- but in the bearish configuration.

It's obvious that in order for gold to even begin to look bullish, the Feb. contract would have to move above 299.3, or let's call it 300. Will that happen? Why guess? Let's just wait to see whether it happens.

A number of long-term gold-watchers believe that the bottom is "in" on gold and that it is just a matter of time before the metal breaks out to the upside. Me, I'm neutral. I think gold is cheap, I know it's not going out of style, but I'm just watching and waiting. Oh yes, there is one thing -- if the dollar heads south, I do think that gold will head higher.



LATE NOTES: OK, what have we got? On the latest rally we got a new high in the S&P 500 and a new high in the Dow. We also got a new high in the high-flying Nasdaq.

We did **not** get new highs in the D-J Transportation Average or the D-J Utility Average. Nor did we get new highs in the Russell 2000 or the broad Value Line Composite. Furthermore, we saw a very sub-standard recovery in the advance-decline ratio.

So the market is now dealing with a number of extremely important non-confirmations -- non-confirmations in the Transportation Average, the Utility Average and the advance-decline ratio.

Now let's examine the nearer-term picture. The advance-decline ratio made a secondary peak on November 6. Despite further highs in the Dow, the A-D ratio traced out three lower peaks. Thus, while the Dow spurted higher, the majority of stocks on the NYSE were in a definite declining trend. This is very negative action.

In my experience, there is no worse action than continued price/breadth divergence, or a situation wherein the Dow continues to push higher while at the same time the A-D ratio records lower peaks and lower lows.

As the technical picture now stands, the worst action we could see would be continued higher Dow peaks while the A-D ratio continues to sag. This process can go on just so long -- until the whole technical structure of the market topples over.

As a corollary, note the weak number of new highs on the NYSE. In a strong market with the Dow advancing, we should see the new high list expanding as an increasing number of stocks break out above previous highs. But that's not what's happening. Actually, what we're seeing is pull-backs in many stocks but very few actually breaking out "in the clear" to actual new high territory. Item: On December 10, for the first time in many weeks, new lows out-numbered new highs on the NYSE.

Another consideration. Note on the page 6 chart that the Dow has carved out a "double top." Also note that in the first top (July) a "head-and-shoulders" pattern appeared. Following that H&S formation, the Dow declined to its late-August low.

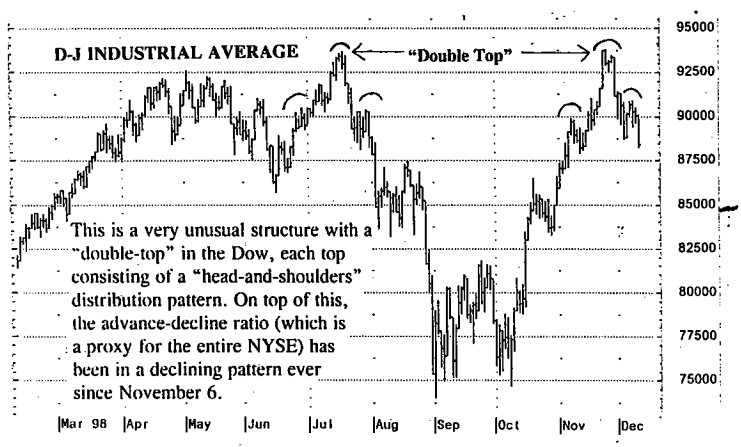
Then we had the violent bear market rally to the November high. Here we see that a second head-and-shoulders formed. The support line for this second H&S pattern was 8880 on the Dow. On the 163 point Dow decline of December 10 the Dow plunged below the 8880 support level, meaning that the H&S distribution pattern has been complete. If nothing else, this action strongly suggests that the big recovery rally is burning out and that the top is in.

Next question: How long will the bear market lows of August-October hold? They could hold for a week, a month, six months -- there's no way of knowing how this bear market will develop any more than there's a way of knowing how a bull market will develop.

I have felt ("my personal scenario") that the market would tend to hold up during December and that the trouble, the real trouble, would begin in January. But, of course, the stock market doesn't arrange itself for Richard Russell's convenience. The Bible tells us that "the wind blowith where it listith." Wall Street history tells us that the stock market (like the wind) goes where it wants -- this despite our forecasts or our wishes.

If the market continues to deteriorate, it would not surprise me to see the Fed drop rates once again. Greenspan knows that a sinking stock market would have the most serious consequences, particularly if it causes consumers to save instead of spend.

Remember, the market and the economy are now confronted with the most fundamental of problems -- world over-production and its resultant forces of deflation.



It's been a difficult year (aren't they all). But I'm still truckin' and I hope you are too. To all my Christian readers, a very Merry Christmas. To Jewish and other religions, my best Season Greetings. To agnostic and atheists, well I guess just have a nice rest and some good dinners. To the Clintons -- well, don't get me started on those two. The next Letter, God willing, will be mailed on Dec. 30. See you all in 1999.